BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE INVESTIGATION BY	)	
THE DELAWARE PUBLIC SERVICE COMMISSION	)	PSC DOCKET NO. 11-330
CONCERNING THE COMPANY'S PROPOSAL TO	)	
ESTABLISH A NEW RESIDENTIAL AIR	)	
CONDITIONING CYCLING PROGRAM	)	
(FILED JULY 28, 2011)	)	

Comments of the Division of the Public Advocate on Staff's October 18, 2012 Report on Delmarva Power & Light's Proposal to Establish a New Residential Air Conditioning Cycling Program

On October 18, 2012, the Commission Staff ("Staff") filed its report addressing Delmarva Power & Light Company's ("Delmarva" or the "Company") application ("Application") to implement a new residential air conditioning cycling program (the "Program"). Staff concludes that the Delaware Public Service Commission (the "PSC") should approve the Program subject to the following conditions:

1) The Company should be required to provide quarterly and annual reports and status updates on Program implementation, costs, revenues, targets and results.

2) The tariff should be modified to include the brand name of the Program and instructions on where to find the Program details.

3) The Company should continue to remove the EFT (Energy for Tomorrow) switches at no cost to the customer and continue to handle any damage claims through its existing claims process.

4) The Company should provide to Staff and DPA copies of all advertising and mailings that will be sent to customers prior to distribution.

5) The Company should be permitted to create a regulatory asset to recover the Program's filed costs ($25,477,246), with the carrying cost set at the current weighted cost of capital.

6) At the end of the Program cost recovery period, the parties should discuss the best way to refund any excess PJM revenues to customers.

SUMMARY OF DPA COMMENTS

- The Program's projected cost is too high, especially given the uncertainties surrounding many of the inputs the lack of actual supporting data and the cost of the regulatory asset.

- The Program's failure to include ex ante performance measures is a fatal flaw. Even such minimal measures as the Company agreed to in the recent rate case relative to AMI are absent.

OVERALL COMMENTS

The DPA first wishes to recognize the effort that Staff has put into its Report. That said, we question whether Staff fully understands the implications of its support of the Program and its recommendation that the Commission approve the Program - unchanged from the Company's original filing (any difference is semantic from our perspective) so long as the Company agrees to file certain reports and updates. First, the Public Advocate is alarmed at Staff's apparent complacency regarding the Company's creation of a yet another Regulatory Asset for a Program fraught with projections and assumptions. Further, the Public Advocate believes that Staff entirely overlooks the substantial amount of new risk placed on non-participating ratepayers, and outright fails to suggest that Delmarva in any way assume any portion of that risk.

The PSC approved the deployment of Advanced Metering Infrastructure (AMI) in Delmarva's service area and directed the parties to "determine the *viability* of implementing any *reasonable* demand-side management or demand response programs in the near term".[1] While the DPA supports that deployment, and supports demand-side management programs, we do not support burdening ratepayers with the costs of programs that have not passed the Commission's test of being either reasonable or viable. The solution to much of this is simple – do not approve the creation of a regulatory asset for these costs.

RAMIFICATIONS OF CREATION OF A REGULATORY ASSET

Before addressing the specifics of the Program and the Public Advocate's problems with Staff's support of the Program, the Public Advocate believes that the PSC should be aware of the ramifications that would flow from its approval of the Company's request to create a regulatory asset for the estimated $25.5 million of Program costs. The Financial Accounting Standards Board ("FASB") addresses regulatory assets in Section 980-340-25-1 of the FASB Accounting Standards Codification titled "Recognition of Regulatory Assets." The pertinent parts of that section provide:

> Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if *both* of the following criteria are met:

[1] PSC Order No. 7420 (September 16, 2008). Delaware Public Service Commission. Retrieved December 28, 2011 from http://depsc.delaware.gov/orders/7420.pdf. (Emphasis added). We will not waste the PSC's time by reiterating the Background Procedural History and Summary of the Application, since that does little to advance an understanding of the DPA's disagreement with Staff and the Company.

- a. It is *probable* (as defined in Topic 450) that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes.

- b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

FASB Accounting Standards Codification 980-340-25-1 (emphasis added).

The Accounting Standards further define "probable" as meaning that "[t]he future event or events are *likely* to occur." (FASB Accounting Standards Codification Glossary) (emphasis added).

Thus, in order for Delmarva to record the $25.5 million of estimated Program costs as a regulatory asset, the PSC must find that it will be likely to approve the entire $25.5 million of Program costs as allowable costs. What this boils down to is preapproval of $25.5 million of *estimated* Program costs. How can the PSC reasonably make such a determination at this point in time when substantially all of the Program costs are estimated? It would be much more reasonable to await the actual expenses before establishing such an asset.

The PSC faced this very same issue in Docket No. 09-414, when Delmarva sought approval to create a regulatory asset for the loss its pension fund sustained as a result of the 2008 global financial crisis. The PSC refused Delmarva's request in that docket because it believed reaching a conclusion, that Delmarva was likely to recover all of the pension loss, would have made it difficult for any other participant to challenge that conclusion when the issue was raised in the context of a rate case. *In the Matter of Delmarva Power & Light Company for an Increase in Electric Base Rates and Miscellaneous Tariff Changes*, Order No. 8011 (Aug. 9, 2011), at 59, ¶155. The same would be true here: if the PSC concluded that Delmarva's recovery of the amount of the regulatory asset was "probable," any participant opposing such recovery in a future rate case would have a tremendous hurdle to overcome in light of the fact that the PSC would have already determined that recovery was likely to occur.

The Company's requested treatment shifts the burden of proof from the Company to ratepayers and signals that the Company has a better than even chance of full recovery. Thus, if the PSC approves it, it will have established a burden on the ratepayers to prove – ex post - that the costs for the Company's plan are NOT recoverable- a perverse "protection'' for ratepayers. The PSC should not tie either its hands or the hands of participants in future rate cases. The Program costs can be examined in a future rate case and the decision made then – on the basis of full information and actual costs – as to the appropriate amount of Program cost to be recovered in rates.

PROGRAM COSTS

The Company presents little hard data to support and explain the approximately $25.5 million of Program costs, which cover everything from marketing to installation to evaluation. According to the Company, it will take this amount to meet a target of 50,000 participating customers by 2015, and the voluntary participation of those 50,000 customers is estimated to reduce peak demand by 61 MW, and to reduce peak energy usage by 2,936 MWH.[2]

Delmarva breaks out the $25.5 million cost as follows:

Cost of devices and installation [3]	$11,491,710
Marketing	6,064,350
Contractor support	3,178,000
Credits paid to participating customers	2,960,375
Program administration (incremental employees)	860,625
Maintenance services	672,187
Program evaluation	250,000
Total Costs	$25,477,246

(Direct Testimony of Stephen L. Sunderhauf, page 8, Table 2, lines 7-10).

The Company proposes to create a regulatory asset for the $25 million of Program costs that will be recovered over 15 years. Curiously, the Company proposes to recover the regulatory asset through base rates from only residential distribution accounts, although it says that this program will help ALL ratepayers by lowering peak loads.

[2] Direct Testimony of Stephen L. Sunderhauf, page 7, Table 1, lines 7-11.
[3] In Docket No. 07-28 - AMI/DSM/Blueprint Working Group, AMI meters (including installation) are projected to cost $140-$160 per meter. Compare this to the $230 per device in this case.

To support its filing, Delmarva provided the following table showing the costs for its sister companies to achieve a one MW reduction through similar programs (see Staff Report page 7):

Program	Years in Operation	Cost Including Incentives	Cost Without Incentives	MW Reduction
Pepco, MD	3	$387,000 per MW	$288,000 per MW	92.6 MW
Delmarva, MD	3	$311,000 per MW	$238,000 per MW	38.0 MW
ACE, NJ	4	$261,000 per MW	$223,000 per MW	27.5 MW
Delmarva, DE		$417,000 per MW	$370,000 per MW	61.0 MW

As can be seen, the cost of Delmarva's direct load control program in Delaware, through full build-out, will be approximately $370,000 per MW, excluding customer incentives or over $80,000 more per MW than the next highest cost. According to Delmarva, the primary factors influencing Delaware's higher cost per MW reduction are the percentage of customers electing to receive outdoor cycling switches (lower cost) versus indoor smart thermostats (higher cost but greater benefit), the use of older style smart thermostats (lower cost) versus the use of newer style smart thermostats (higher cost), and per participant recruitment marketing and education costs. Delmarva projects that initially 70% of Delaware customers will select a smart thermostat and 30% will select an outdoor switch; however, the ratio of smart thermostats to outdoor switches may change as installations progress. Delmarva expects that its concurrent implementation of dynamic pricing will increase the desirability of smart thermostats, which would thus also increase Program costs as well..

REGULATORY ASSET

Staff believes the Company should be allowed to recover appropriate costs (Staff Report at 10), and we do not take issue with this: in fact, it's an obvious restatement of the law. But Staff seems to assume, **without question**, that the Company's projected and assumed $25.5 million of Program costs *are* appropriate, and that as long as the Company agrees to file reports containing certain information, Staff will fully support the Program. The DPA struggles to understand Staff's quid pro quo, as well as the difference between Staff's recommending approval and what "fully support" adds to the discussion.

From the DPA's perspective, Staff seems to accept the regulatory asset as a *fait accompli*. Staff attempts to dress this support up by capping the regulatory asset at Delmarva's projected costs of $25,477,246 but *then* - rather than drawing a line in the sand regarding this cost cap - provides *another* off ramp for DPL to recover additional expenses if the projections turn out to be too low. If the Company determines that Program expenses will exceed $25,477,246, or if the Company reaches the MW reduction goal prior to the expenditure of the full $25,477,246 projected cost, the Company must apply to the PSC for approval of additional Program expenditures. (Staff Report at 10).[4] It is surprising that Staff requires approval for Delmarva to receive additional funding, yet remains silent on the process by which Delmarva would be required to address the possibility of *over*-funding. The DPA anticipated some Staff recommendation regarding the process by which excess funding will be returned to ratepayers. That none was offered is disturbing.

Next, Staff's report offers no comment on its evaluation of the reasonableness of the Program's projected costs, despite its "**concern about the cost of the program**" (Staff Report at 11) (emphasis added).[5] Yet the DPA cannot discover where that concern found its way into Staff's "conditional" support for the Program. The DPA fails to understand why Staff is supporting – even conditionally (which is Staff's term for its support) a proposal about which it has such cost concerns. For example, projected marketing costs for EACH unit installed exceed $120, an incredible marketing expense per unit. The DPA has no information as to whether the DLC devices themselves were bid out or whether the selected bid represented the lowest cost. Total "soft costs" or non-hardware costs represent $157 per unit.[6] Yet, even after a review of other states' experience, Staff seems to simply accept these projections at face value. At least no analysis of matters such as these is apparent in Staff's comments.

The DPA is particularly nonplussed that one of Staff's "conditions" for supporting the Program is that the unamortized balance of the regulatory asset earn the Company's currently authorized rate of return - which is 7.61% - even though the Company has based its cost/benefit analysis on a 4.6% discount rate. (Staff Report at 2). In its summary of conditions, Staff does not even recommend the obvious – a lower carrying cost reduces the potentially adverse impact on ratepayers. At a minimum, one

[4]Staff's Report includes Delmarva's explanation of why the projected Program costs in Delaware are higher than the program costs in other states. (Staff Report at 8). Apparently Staff found that explanation sufficient since it did not probe further.
[5]The DPA notes that Staff devotes (if one is generous) about 1.5 pages of its 10.5-page report to discussing cost. The rest of the document regurgitates Delmarva's Application and the conditions for full Staff support.
[6] "Soft" costs are marketing, program administration, maintenance and program evaluation costs.

would think that Staff would require that DPL use the same value for both pieces of the analysis (return on assets and discounting future costs and benefits), yet it gives no indication which position it takes on the issue. Failure to do so artificially raises the benefits level. Simply put, if a dollar grows at 7.61% and then decreases at 4.6%, the dollar's value will always be higher at the end of the period. At a minimum, the two figures should be consistent so that the result is transparent.

DPA COMMENTS ON STAFF'S REQUIREMENTS FOR FULL SUPPORT

After reviewing the Application, participating in workshops, and informal discovery conferences, Staff concludes the Commission should approve implementation of the proposed Program, along with its $25.5 million Regulatory Asset. However, in order for Staff to **fully support** the Program, it requires the following:

1) Quarterly reports to Staff and DPA that include, but will not be limited, to the following:
    a. The year to date marketing costs for the program;
    b. The marketing costs for the quarter;
    c. Budgeted marketing costs for the quarter;
    d. Deviation of actual from budget with explanation for cause of deviation;
    e. Number of enrollments (year to date and quarter);
    f. Number of installations (year to date and quarter); and
    g. Budgeted marketing costs for next quarter.

2) Annual reports to Staff and DPA that include, but will not be limited to, the following:
    a. Number of enrollments and number of installations;
    b. PJM Capacity revenues credited to the Energy Wise Rewards Program (stated separately from revenues credited to the dynamic pricing program);
    c. PJM energy market payments resulting from DR being called;
    d. Ongoing balance of money paid to customers versus monies collected from PJM;
    e. Costs of program;
    f. Dates of cycling events, duration of event, reason for event;
    g. Participation level for events including number of customers and MW reduced; and
    h. Progress toward state energy goals.

(Staff Report at 8-9).

It appears to the Public Advocate that Staff is more comfortable acquiring reams of data rather than answering the basic question, "Is this program a reasonable demand side program?" If that question is answered in the negative – as it should be - Staff's reporting requirements are superfluous and inefficient. Moreover, Staff neglects to say what it plans on doing with the encyclopedic data it seeks except to check on "progress." Strikingly, Staff remarks that its conditions add "customer protections" (Staff Report at 11), but if these additional reporting requirements are what Staff considers "customer protection," the DPA is unable to discern how they protect customers.

Staff further states that its conditions "ensure a continued dialogue between the parties as the program is launched and customers begin to enroll." (Staff Report at 11). There is no reason to expect that there would not be "a continued dialogue" if the Program goes forward even without these conditions. But even if there was none, the Delaware Code provides that the Commission "shall *at all times* have access to and the right to inspect and examine any and all books, accounts, records, memoranda, property, plant, facilities and equipment of all public utilities." 26 *Del. C.* §207 (emphasis added). And Section 8716(d)(5) of Title 29 of the Delaware Code gives the Public Advocate the same access and inspection rights to the books, records, etc. of public utilities as the Commission has. 29 *Del. C.* §8716(d)(5). In any event, "a continued dialogue" provides no direct, documentable consumer protection and is, in the Public Advocate's opinion, a red herring of consumer protection.

DPL REQUESTS - AND STAFF SUPPORTS - A MASSIVE SUBSIDIZATION OF THE PROGRAM

Perhaps most troubling to the Public Advocate is that both Staff and Delmarva conveniently ignore the huge subsidy flowing from all residential ratepayers to those who enroll in the program. This subsidy is easily shown by some simple math:

- $25,477,247 (total costs) / 50,000 (subscription units) = $**510** cost/unit.
- $25,477,247 (total costs) / 275,000 (residential customers) = **$93**/unit
- Subsidy = $510 - $93 = **$407/ unit.**

This means that the Company projects that 20% of the ratepayers are subsidized for 80% of the cost. It is difficult for us to contemplate the PSC approving a subsidy of this size (roughly $20 million) and the Public Advocate would most vigorously oppose such an uneconomic solution. Why would Staff agree to such a uneconomic proposal such as this, unless it simply failed to recognize the subsidy existed or recognized it and simply rejected the principle of cost causation?

THE REGULATORY ASSET AND ITS COST

As is obvious by now, the Public Advocate adamantly opposes approval of this more than $25 million regulatory asset.[7] The Public Advocate has supported accounting treatment like this in the past and for large amounts (indeed, the Public Advocate supported creating a regulatory asset for AMI costs), but the basis for the size of the requested regulatory asset in this case is flimsy at best. DPL has used estimates, projections, and judgment to reach its $25 million figure. In today's world (and perhaps in any world), that is simply unjustified without some checks and balances. The Company does not **need** this asset to move forward with the Program. And since it expects to request recovery of the Program costs in its next rate proceeding, we should let it demonstrate the reasonableness of its projections by accruing several years of progress and history to determine what, if any costs, should be carried for 15 years.

The Company proposes to recover the $25.5 million of Program cost over 15 years at a 4.6% carrying cost. Staff supports the 15-year recovery period. We sometimes forget (or ignore) the size of the return on such an asset which does not represent used and useful facilities. Even assuming a 15-year life at 4.6%, the value of the carrying costs is over half a million a year.[8] Giving DPL that kind of riskless return is simply charity in a time of unending pressure on customer bills.

Delmarva suffers no harm if the PSC rejects its request to create a regulatory asset. It simply will have to wait until the components become used and useful - the statutory standard for allowing additions to rate base. At the end of three years (according to the Company's projections), the entire initiative should be in place and it can then demonstrate the accuracy (or not) of its projections and the used and useful nature of its equipment and facilities and include it in rate base. As far as the softer components, the Public Advocate respectfully submits that it is generally not good regulatory policy to allow a utility to establish a regulatory asset earning a return until it is used and useful.

Above all else, we cannot ignore the impact on ratepayers. The PSC will soon consider approval of a rate case settlement of approximately $22 million, which provides for a phased recovery of Delmarva's investment in AMI. If approved, then over the next 12 months Delaware residential customers will be bound to pay an additional $22 million in annual rates added to an essentially guaranteed recovery of a

[7] Should the PSC approve regulatory asset accounting for this Program—which it should not—then, at a minimum, it should not allow pre-approval for the unsupported (and as yet unincurred) "soft" costs of marketing, etc.

[8] On average, approximately $12.5 million will be on the books. $12.5 million x 7.61% gives us a conservative estimate of over $950,000 a year in accrued earnings. If Delmarva files a rate case that becomes effective in year 4, then about $4 million of carrying costs will have accrued.

regulatory asset valued at $25.5 million places Delmarva's customers on the hook–for $47 million in a single year. And for what reason? So Delmarva, with Staff's assistance, can throw all uncertainty (and hence the risk) of its own projections and estimates onto all ratepayers---not only those who will benefit as participants, but also those who won't.

<u>PERFORMANCE MEASURES</u>

Delmarva has provided estimates and projections with which it apparently feels comfortable. Otherwise, it would not have filed them. But we have all experienced the uncanny ability of actuals to look nothing at all like estimates - it is simply the nature of being unable to introduce certainty into the future. Nonetheless, Delmarva and Staff would have us place that uncertainty (i.e., risk) on the backs of ratepayers. Suppose the Company doesn't get 50,000 subscriptions? Suppose it runs into issues that require a longer rollout period (during which time, of course, the asset continues to earn a return?) Those costs should not be borne by ratepayers.

The Company believes in its costs and timetable - and the Public Advocate suggests that the PSC should hold DPL to them. Now the issue becomes that if the Company believes its numbers and analysis, why isn't it willing to put some money where its mouth is? It has no problem asking *ratepayers* to put their money up. The Company should submit a plan for mitigating customer exposure to the risks inherent in predicting the future, predicting peoples' behavior and predicting the level of success.

We note that the Company has stated that its evaluation of benefits to costs ratio is 2.1 to 1. (Direct Testimony of Stephen L. Sunderhauf at page 9, Table 3, lines 16-18). If the Company believes that to be even reasonably accurate, then for every $1 of outlay, the project produces $2.10 of benefits. A simple way of ensuring some minimal customer benefits is to only approve 50% of the regulatory asset value - in essence, incorporating only some of the promised benefits into the initial accounting mechanism. Moreover, if the ratio is indeed over 2 to 1, then DPL's request for a regulatory asset is overkill. Let us wait until it files for recovery before we allow any deferred cost accounting.

CONCLUSION

The PSC should decline to create a regulatory asset for the estimated and projected Program costs. There is no compelling reason to approve it. If the Company wishes to accrue the costs of this Program, let it do so at its own risk.

The Company should bring any request for funding before the PSC in its next rate filing so that its rollout projections can be compared to its actual experience and projected values can be assessed against actual values of expenses and capital requirements.

The PSC should order the Company to propose performance based measures, so that risks are shared between shareholders and customers, should the Company be unable to fulfill its obligations to meet its own estimates of future benefit to cost predictions and the length of the rollout period. In particular, the benefit-cost ratio of 2.1 should be a cornerstone of such measures.

Commissioners, this is not nearly as complicated as some would suggest. Simply deny DPL approval to establish a regulatory asset. The Company can do whatever it wants from there. If the Company proceeds with the Program despite the rejection of a Commission approved regulatory asset, we can evaluate the Program from a clean slate - not subject to some preordained outcome that would flow from an approved deferred accounting.

/s/ *Regina A. Iorii*

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